NEW YORK TIMES

June 29, 2008

By VIKAS BAJAJ

When Congress started fashioning a sweeping rescue package for struggling homeowners earlier this year, 2.6 million loans were in trouble. But the problem has grown considerably in just six months and is continuing to worsen.

More than three million borrowers are in distress, and analysts are forecasting a couple of million more will fall behind on their payments in the coming year as home prices fall further and the economy weakens.

Those stark numbers not only illustrate the challenges for the lawmakers trying to provide some relief to their constituents but also hint at what the next administration will be facing after the election. While the proposed program would help some homeowners, analysts say it would touch only a small fraction of those in trouble — the Congressional Budget Office estimates it would be used by 400,000 borrowers — and would do little to bolster the housing market.

“It’s not enough, even in the best of circumstances,” said Mark Zandi, chief economist of Moody’s Economy.com. The number of people who will be helped “is going to be overwhelmed by the three million that are headed toward default.”

Last week, the Senate voted overwhelmingly to advance the bill, and the House passed a version last month. Because of procedural delays in ironing out differences between the two houses, the Senate is not expected to pass the bill until after the Fourth of July recess.

The bill would let lenders and borrowers refinance troubled mortgages into more affordable 30-year fixed-rate loans that are backed by the government. Democratic leaders say Congress could send something to the president next month.

The White House, which initially threatened to veto the measure, has indicated that it is open to supporting the bill if certain provisions are removed.

“The Congress needs to come together and pass responsible housing legislation to help more Americans keep their homes,” President Bush said on Thursday.

Representative Barney Frank, Democrat of Massachusetts and a central force behind the legislation, said on Friday that recent reports about falling home prices have rallied support for the plan. But he acknowledged that the plan may not do enough to help homeowners or the housing market. Mr. Frank, chairman of the House Financial Services Committee, said that even after a bill like this, “you may need more.”

Other proposals that have been floated in Washington include expanding the current plan to make it mandatory instead of voluntary for certain home loans; having the government buy loans outright from lenders; and providing some way and some incentives to let homeowners become renters in their own homes.

But not everyone supports government interventions. Some Republicans, like Senators Jim DeMint of South Carolina and Jim Bunning of Kentucky, say the proposal would use government subsidies to bail out reckless lenders and borrowers. They suggest that the housing market will correct itself more quickly if Congress does not intervene.

The biggest impediment to helping homeowners is the weak economy. In addition to falling home prices and risky loans, homeowners are now confronting a tough job market. The unemployment rate has risen to 5.5 percent, up from 4.9 percent in January.

Mortgage rates have also been climbing. An estimated nine million homeowners owe more than their homes are worth and could find themselves with few options if they lose their jobs or if their mortgage bills rise substantially.

To take part in the proposed program, lenders would have to lower each debt obligation to 85 percent of the home's current value. Borrowers would stay in their homes but would have to pay a 1.5 percent annual insurance premium. If homes' values grow and borrowers sell or refinance, they would have to share the gain with the government.

The program would be managed by the Federal Housing Administration and paid for by the insurance premium, as well as a 3 percent fee paid by lenders and a tax on Fannie Mae and Freddie Mac, the government-sponsored buyers of mortgages. (The refinance proposal is part of a broader housing bill that would also overhaul laws relating to the two companies and the F.H.A.)

To qualify, borrowers would have to be in enough trouble that they could not afford their current mortgage payments but financially strong enough to make payments on their new loans.

"No matter how you fiddle with terms of their present situation, it's not going to save the day" for many borrowers, said Bert Ely, a housing finance consultant based in Washington. "They are not in a good financial situation because they have lost their jobs and they are overburdened with credit cards and home equity loans."

The effectiveness of the bill will depend to some extent on how it is handled by the F.H.A., an agency created during the Great Depression to insure home loans. It will have several challenges: persuading the lenders who made second mortgages and home equity loans to cooperate; screening loans to make sure borrowers have a good shot at keeping their homes after refinancing; and weeding out those trying to take advantage of the system.

Second mortgages and home equity loans were popular during the housing boom and often allowed Americans to buy a home with little or no money down or let them take out cash against their homes as prices rose. Now, home values have fallen so much that there is little or nothing left to pay off these loans when homes are sold or repossessed. The Congressional Budget Office estimates that about 40 percent of riskier mortgages made in recent years are coupled with such secondary loans.

Under the Congressional plan, these loans would have to be eliminated before homes could be refinanced. People who negotiate loan modifications say holders of second loans have been reluctant to take losses, and lenders with first loans are often unwilling to give them enough money to secure their cooperation. Under the Senate version of the plan, the F.H.A. would have some leeway in negotiating with borrowers who have second loans.

Another challenge for the F.H.A. would be selecting borrowers who have the best chance of paying off new loans. The agency would have to make sure lenders are not unloading only their worst loans, and lenders and the F.H.A. would have to guard against borrowers who can pay their current loans but would like a cheaper, government-backed loan.

Even if the agency insures hundreds of thousands of new mortgages, analysts do not expect the tide of foreclosures to ebb until the economy improves markedly. Mr. Zandi and others forecast that two million to three million mortgages will default — beyond the three million in trouble now — and economists at Lehman Brothers say home prices nationally may drop 15 percent by the end of 2009. That may force policy makers to consider further interventions.

“In this rush to legislate and with the lack of discussion of a lot of issues, people will look at this bill in the winter and say we shouldn’t have done this, we shouldn’t have done that,” said Mr. Ely, who closely followed the savings and loan debacle. “The politics are going to be so different come next year. There will be another administration, and who knows what the makeup of the House and Senate will be.”

There is a precedent for such government endeavors, but not since the New Deal. In the 1930s, the government created the Home Owners Loan Corporation to buy mortgages and modify them. In three years, it bought a fifth of the country’s home loans, said Alex J. Pollock, a resident fellow at the American Enterprise Institute in Washington.

“We won’t need to do anything of that magnitude here,” he said.

An official for the Mortgage Bankers Association, a trade group in Washington, acknowledged that the proposal may not help the majority of troubled borrowers, but said it would be a good start and would help restore confidence in the financial markets and the economy.

“There is no silver bullet,” said the official, Steve O’Connor, a senior vice president of the association. “There is no single solution to the housing crisis. It will take multiple tools to turn the housing market around, and it’s going to take time.”